

GEORGIA ENVIRONMENTAL FACILITIES AUTHORITY

PAUL R. BURKS
Executive Director

SONNY PERDUE
Governor

March 31, 2003

MEMORANDUM

TO: Hank Huckaby
Chief Financial Officer
Office of Planning and Budget

FROM: Paul Burks *PB*

SUBJECT: GEFA Recommendation Related to Proposal to
Securitize the State-funded GEFA Portfolio

Enclosed in this package is a detailed discussion and recommendation related to the proposal on the securitization of the state-funded GEFA portfolio.

In summary, based on the legal, financial, and policy considerations contained in the following memo, I believe that the securitization of GEFA's state loan funds should not be pursued. The information contained in this material shows that securitization is extremely uncertain, very complicated legally, will be financially costly by significantly reducing funding available for future water projects, and would violate two decades of trust established between state and local government in the partnership to construct environmental facilities.

Thank you for this opportunity to provide my recommendation. If you have any questions, please let me know.

PB:ypf

ENCLOSURE



GEORGIA ENVIRONMENTAL FACILITIES AUTHORITY

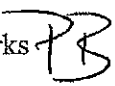
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Recently you and I met to discuss various issues related to Georgia Environmental Facilities Authority. At that time you asked me to provide my recommendation concerning the proposal to securitize the state-funded GEFA portfolio.

As you know, this particular issue was raised with GEFA in mid-January by the Office of Planning and Budget. As I understand, the reason for such a request is to provide funds to the state treasury to assist in improving the state's financial situation. GEFA was asked to review this matter and make a report to the Office of Planning and Budget. In reviewing the proposal, three distinct issues arose that are addressed in this memo: Legal, Financial, and Policy concerns.

LEGAL

The state program developed for GEFA in the early 1980's required not only legislation, but two constitutional amendments. In addition, guaranteed revenue bonds were sold in 1991 - 1992, and later refinanced in 1997 - 1998. The combination of these factors creates a very complex legal situation for anyone wishing to securitize the GEFA funds. Ms. Shirley Kinsey of the Law Department has written a very detailed review of the issue related to GEFA debt securitization in response to a request from me in February. A copy of her advice is attached. However, I believe it is important to summarize the important points of her memorandum. These include:

- All GEFA revenue (all repayments on loans that would be the basis of securitization) are pledged to the bondholders of GEFA's Guaranteed Revenue Bonds under the Master Bond Resolutions. Any amendment to these bond resolutions would have to be approved by the Georgia State Financing and Investment Commission Board.

- A grantor trust would most likely need to be established to deposit funds under a securitization. The issue would need to be addressed on who would bear the risk of taxability on the state-funded loans: GEFA or the owners of the certificates. Due to the nature of our program, no legal opinions on the tax-exempt status of the interest on our state-funded loans have ever been required or issued. Without such legal opinions of nationally recognized bond counsel, the future owners of GEFA certificates would bear the risk that the interest on our loans could become taxable, thereby negatively affecting the price we might receive. To mitigate this risk, we would need to create a contingent liability of GEFA, which could negatively impact the value of the fund.
- A greater concern than the above relates to the fact that GEFA's loans to local governments have always been classified as intergovernmental contracts. The sale of the funds may cause the loans to lose this status. Losing this status would render contracts as invalid obligations under the debt limitation provisions of the Georgia Constitution, and could cause a significant problem for local governments in that GEFA borrowing does not count against their mandated 10% debt ceiling limitation. Also complicating this matter, GEFA borrowing does not require a referendum by local governments. The repercussion of the above to local governments is unknown.
- Currently, to provide a high level of customer service, all GEFA loans may be prepaid at any time without penalty to the local government. Therefore, likely purchasers of the loans will not have the guarantee of payment over time that they prefer. This will probably make our loans less valuable to potential investors.
- Ms. Kinsey reviewed the issue of the State Retirement Systems' purchasing GEFA's portfolio. A statutory change would likely be required to allow this. She also raised a concern that the retirement boards could possibly violate their fiduciary responsibilities by purchasing GEFA loans, as the rate of return would be far below what the retirements systems normally receive.
- As the sole purpose of this securitization is to eventually transfer funds from GEFA to the state treasury, the matter of the legal permissibility of this was explored. GEFA's program was established to continually provide low-cost financing to local governments for water and wastewater projects. The legislation that established the GEFA program did not envision a day when this work would be completed, in that water needs are essentially never-ending. Since it was not anticipated that these funds would ever be "surplus," no mechanism was written into GEFA's legislation to allow funds to be transferred to the state treasury. Therefore, the Law Department advises that if securitization occurs, it would be prudent to have the General Assembly amend GEFA's statute expressly for the purpose of transferring the funds from the existing program to the state treasury.
- Lastly, while the Law Department cannot advise on the potential impact of this securitization on credit ratings, they do assert that concerns regarding future credit and future ratings, in light of the proposed transaction, rest not only on GEFA, but also with the State of Georgia itself.

FINANCIAL

In March, 2003, based on a request from the Office of Planning and Budget, GEFA entered into an agreement with the state's financial advisor, Public Resources Advisory Group (PRAG), to provide financial advice on a possible securitization of the state-funded GEFA loans. A copy of the full report is attached.

In summary, PRAG reviewed two alternative structures for raising funds: (1) actual sale of the loans, and (2) a securitization, where a pass through interest in the cash flows is sold to investors with the loans being retained and serviced by GEFA.

Under (1) actual sale or asset sale, PRAG believes that since the weighted average interest rate is not particularly high (4.85%), the loans most likely would be sold at a substantial discount to par. PRAG believes that this discount is so large that this option should not be pursued.

Under (2), the securitization approach, GEFA would pledge the state-funded loan cash flows to a trustee. The pledged cash flows could be used to repay, with excess coverage, a tax exempt bond issue.

Such a bond issue would provide excess funds of only \$188 million after all costs are paid, including a \$20.8 million debt service reserve fund. PRAG estimates that such a securitization will diminish GEFA's ability to fund water and wastewater projects by approximately \$330 million. Therefore, financially, such a securitization would appear to be extremely detrimental to the future of the water and wastewater financing program. In addition, such a securitization would challenge the fiduciary duties of the GEFA Board of Directors in their role as trustees of the state's water and wastewater fund.

POLICY

In reviewing the securitization of the GEFA loans, it is extremely important to review the policy side of the program – the service it provides to its customers, local governments, and the impact of selling the portfolio on the ability of GEFA to perform its mission.

To begin, the selling of the state-funded loans would have a negative impact on the ability of Georgia cities and counties, particularly small and rural communities, to finance and construct their water projects. It would also negate a long-standing commitment the state has made to be a partner in helping local governments with their infrastructure needs.

When GEFA was created in the mid-1980's, the financial goal was to create an agency that would make loans from state funds and eventually have a repayment stream of \$20 million per year that could be loaned to Georgia's communities. After nearly 20 years, GEFA has finally reached that goal. Due to this repayment stream, which has been paid for by local governments through their very conscientious treatment of the GEFA loans, we now have a program that is available to make loans to all local governments throughout the year. Local governments have shown their responsibility to the program

in that there has never been a default. There exist few other programs in the nation like it to help small local governments with their water needs. If the portfolio was sold and the repayment stream went elsewhere, it would have a devastating effect on the program.

If the state also cut off its G.O. funding to GEFA and directed GEFA to issue revenue bonds to make up for the loss of the repayments, as has been suggested, the impact would be even worse. GEFA must have at least \$8 million per year in non-federal funds to match against some \$40 million in federal loan funds. Revenue bonds are not an allowable state match to the federal program, as the repayments go to the bondholders and not back to the fund as required by the U.S. EPA. (We tried this approach in 1991-1992 with Guaranteed Revenue Bonds and U.S. EPA questioned some \$60 million in loans. An elaborate repayment schedule had to be devised to "pay back" the federal program. We do not want to repeat that unfortunate episode.) Also, in regard to U.S. EPA, the selling of the state portfolio and removing state funds from the program will probably cause the federal agency much concern. They will lose the assurance of the annual required state match, thereby jeopardizing the state's ability to receive some \$40 million in annual federal appropriations. Also, by removing all of the state funds from GEFA, we would have no way to invest and raise revenue for our expenses. We would need a new state appropriation of at least \$1.5 million annually to operate our programs. Currently, we receive no state funding, operating on the investment interest of the state loan repayments.

If we are left with a program that is federally funded only, it would not allow the flexibility local governments in Georgia need. The state funded program and the federal program are not interchangeable. We have much more flexibility with the state money. For instance, we cannot use federal monies for water lines to help a community serve a new industry or attract new investment. However, we can do so with the state funds. By taking away GEFA's state funds, we would not be able to help many small, rural communities who need to put in the water and sewer systems to attract industry and create or retain jobs. Unfortunately, if they can't get a GEFA loan, most have no easily affordable place to go for water and sewer assistance.

One of the most important things to remember about GEFA's water and sewer loan program is the origination of the loan repayment stream. GEFA currently has some 900 loans approved with over 300 communities, which is 50% of the local governments in Georgia. The value of all loans both federal and state is over \$700 million. Not all of these loans are in repayment due to the fact that project development and construction can take 1- 3 years. Currently \$230 million in state loans are in repayment. None of the federal loan repayment fund can be utilized for anything but additional federal water and sewer loans. With this in mind it is important to note that of the many communities borrowing money from GEFA, 60% are under 10,000 in population and the average loan size is approximately \$1.2 million. These are small communities with limited resources. A review of the loan recipients shows that small communities such as Ashburn, Blackshear, Byron, Cecil, Collins, and Metter predominate. These communities like the program because the money is always available, the process is simple, the loan repayment money goes back into the fund to make more water and sewer loan available to rural Georgia and the interest rates are low, saving the communities considerable

money. In fact, we found that the GEFA program has been saving Georgians approximately \$18-20 million per year in reduced interest costs over the life of the loans approved, which is equal to the average annual state investment in the program. If the state takes the repayment stream and/or the state funded portfolio, then the state is taking money paid by the water users of communities across Georgia and directing that money to other purposes rather than the promised intent of continuing to help Georgia communities with their water needs. The local officials that I work with on a continual basis would find this to be a very serious violation of the trust that has been developed by this program over nearly two decades.

Over the past several years, the state EPD has been much more aggressive in issuing consent orders to local governments throughout Georgia to enforce compliance on various water quality regulations. These enforcements require these local governments to incur tremendous expenses for the size of their tax base. These communities come to GEFA to get the money to comply with these orders. It would be very ironic for the state to force local governments to make water quality improvements and then take away the heart of the funding mechanism they use to finance the work.

Since 2001, the Metro North Georgia Water Planning District has been meeting to develop the water plans for the sixteen county area of metro Atlanta. A very important part of their planning relates to financing of the water projects that will be recommended through this process. The District's local governments are counting on GEFA to play a role in financing a portion of the projects that result from the studies. While the state's water policy has not been developed, if the state wishes to be involved in providing financial assistance to the District's communities, the state may wish to preserve GEFA's ability to "leverage" its funds.

In 2002, the state's Financial Advisor examined GEFA's program and estimated that through leveraging GEFA could assist, over a 20 year period, with financing from \$5 to \$7 billion of the nearly \$50 billion in projected water needs of the District between now and 2030. However, a critical part of GEFA's ability to finance these projects comes from our state repayment stream as well as future G.O. Bond sales. Depriving GEFA of the state repayment stream and G.O. Bonds would severely limit the ability of GEFA to assist local governments by taking away our ability to fully leverage the GEFA portfolio.

Even if the state determines it is not important to assist the Water Planning District, many communities in Georgia are currently working with GEFA on multi-year funding strategies on wastewater projects. The City of Atlanta plans to borrow nearly \$350 million from GEFA over the next decade, the City of Columbus hopes to borrow nearly \$60 million over the next 3 years, and Gainesville and Hall County plan similar activities. By removing the state repayment funds and replacing it with revenue bonds, GEFA can not match the federal loan programs and will be hampered in its ability to assist these communities.

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CONCLUSION

GEFA is unlike most state agencies or authorities in that, by law, a majority of our Board members are local government officials. Therefore, our program is very much a "local" program with policies set by local officials to serve all of Georgia. For this reason, local governments feel a sense of ownership of GEFA, and with good reason since all the repayment monies that make up a large part of our program come from these local governments. Local governments have trusted the State of Georgia with this program for many years. I sincerely believe that any change to the existing program, particularly related to the diversion of the loan repayments, will be profoundly felt by the local government community, particularly if changes are made without their advice and consent.

Therefore, I believe it is critical that no change be made to the repayment stream and state loan portfolio of the Authority. I believe such a change will seriously impair the ability of small local governments in Georgia to improve their water facilities for either economic development or environmental reasons.

Thank you for the opportunity to have input into this process. As always, I would be pleased to discuss this matter further and answer any questions you may have.

PB:ypf

ATTACHMENTS